providing services to mass market consumers. Clearly, the elimination of WorldCom as a maverick wholesaler would raise costs for resellers, who in turn would increase rates charged to mass market customers.[28]

B. Contrary to the Applicants' Claims, Different Geographic Markets Apply to Wholesale and Retail Services and the Effects of the Merger on Mass Market Retail Services Must Be Examined on a Localized Basis.

MCI and WorldCom claim that there is a single nationwide long distance market. This assertion is wrong. It is true, however, that wholesale network services are bought by resellers on a nationwide basis. That is, a reseller such as GTE can effectively obtain underlying capacity only from a facilities-based provider with a nationwide system. Today, and for the foreseeable future, less than a handful of carriers – led by WorldCom – can satisfy resellers' capacity needs nationwide, as discussed in Section II.C below.

Notabley, a narrower geographic market is applicable to both point-to-point transport, an input to the provision of wholesale network services, and to retail services. With respect to transport, there are capacity shortages on individual routes that create different market conditions among different city pairs, as GTE explained in its March 13 Comments and Dr. Harris's initial Long Distance Affidavit. The Applicants, of course, have provided no information regarding their dominance on particular routes.

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[28] Similarly, the Applicants' claim is entirely inconsistent with their assertion that it is the "other" category of carriers that will provide competition in the future, since this "other" category consists mainly of resellers relying on WorldCom's services. *See* Section II.C, *infra*.

With respect to retail services, the Applicants rest their claim that the geographic market is nationwide primarily on the Commission's rate averaging requirement.[29] In reality, however, the rate averaging requirement does not support a nationwide geographic market definition, particularly for mass market retail services. Looked at from a demand standpoint, as is clearly required under Commission precedent, the retail market for mass market long distance services should not be larger than a LATA.[30]

The rate averaging requirement has no impact on market definition for retail services for several reasons. Despite the requirement to offer the same rates throughout their service areas, carriers vary the level of marketing in different areas, such as advertising new discount plans in some areas but not in others. IXCs target the marketing of their discount plans only to high revenue, low cost, or more competitive areas, effectively engaging in price discrimination. AT&T and MCI spend significantly more on advertising and marketing on a per capita basis in large urban areas like New York City and Los Angeles than they do in smaller markets.[31] As a result, customers in the latter locations pay higher effective rates, notwithstanding the theoretical availability of plans offering lower rates.

Another way carriers offer location-specific discounts notwithstanding the rate averaging requirement is through intrastate rates. For example, when SNET entered

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[29] Second Joint Reply, Carlton/Sider Declaration at 12-13.

[30] *See* Harris LD Reply Affidavit at 7.

[31] *Id.* at 15.

the long distance market in Connecticut with lower prices than AT&T, AT&T responded not by cutting its retail long distance rate throughout the country, but rather by lowering intrastate rates in Connecticut so that customers' overall toll bills decreased.[32] A study of intrastate rates across the U.S. shows that this strategy of lowering intrastate rates is frequently employed by large IXCs in response to competition.[33] With intrastate calls making up 25 percent of interLATA calls, varying intrastate rates can make a substantial difference in customers' overall toll charges. Consequently, the effects of the merger on the retail market must be examined on a relatively localized basis.

C. The Applicants Cannot Blink Away Substantial Entry Barriers in the Wholesale Market in Order To Create an Unlimited Universe of Most Significant Competitors.

MCI and WorldCom dispute GTE's showing that the Big Four IXCs are the only significant competitors in the wholesale market, arguing that there are no fewer than ten nationwide networks that already do or will shortly compete with WorldCom.[34] They also assert that (1) "[a]s a totality, the competing long-distance networks have already achieved significant nationwide coverage"[35]; (2) the RBOCs must be considered

[32] *Id.* at 11.

[33] *Id.* at 11-14. For example, MCI's discount plans charge different rates for interstate and intrastate calls, as do most of AT&T's and Sprint's discount plans.

[34] Second Joint Reply at 29, 33.

[35] *Id.* at 30-31.

significant potential competitors[36]; and (3) the growth of the "other" category of IXCs belies GTE's argument that there are substantial barriers to entry.[37]

Because the Applicants' arguments boil down to an assertion that there are no significant barriers to entry, GTE will treat the identification of competitors and barriers to entry portions of the *Bell Atlantic/NYNEX* analysis together., GTE will demonstrate that substantial barriers to entry do exist and that neither the RBOCs nor other new entrants will be effective competitors in the wholesale market for at least five years.

1. New entrants will not obtain sufficient population coverage for at least five years to provide effective competition in the wholesale long distance market.

The Applicants acknowledge that, under the Merger Guidelines, new entry can be considered to ameliorate competitive concerns raised by a merger only if it is timely, likely, and sufficient.[38] Contrary to the Applicants' claims, however, none of the new networks, either individually or taken together, meets this standard. For example, in their Declaration, Drs. Carlton and Sider state that "the population coverage of the new networks will be extensive, reaching nearly as large a share of the population as WorldCom today."[39] Unfortunately, this is not actually the case; each of the networks to which they cite has drawbacks that render it a poor substitute for WorldCom as a supplier of wholesale capacity. Rather than the seven or more nationwide networks

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[36] *Id.* at 36.

[37] *Id.* at 31-33.

[38] Second Joint Reply, Carlton/Sider Declaration at 16.

Drs. Carlton and Sider claim will serve consumers, about 83 percent of the population is served by four nationwide networks today, and the number of networks would be reduced to three if the merger were approved.[40]

As WorldCom itself noted recently, assuming that "transmission technology ... is the same thing as the service being transmitted" is "a fundamental misunderstanding....While one permits the other, they are not equivalent."[41] MCI has been equally candid. In responding to claims of competitive superiority by Qwest, Jack Wimmer, MCI's executive director of network technology and planning, stated that:

> I see a lot of hype about the kind of fiber they're carrying the network on, but not about anything else .... I mean, do they have consolidated billing for their business customers? The fundamental difference between carriers is not the fiber. The real difference is the range of services they provide.[42]

Drs. Carlton and Sider confuse one of the inputs for building a long distance network with being able to provide long distance services. As Drs. Schmalensee and Taylor explain, "WorldCom offers a wholesale service – an integrated nationwide

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(...Continued)
[39] *Id.* at 10.

[40] Schmalensee/Taylor Reply Affidavit at 9.

[41] Consolidated Opposition of WorldCom, Inc., CC Docket Nos. 98-11, 98-26, 98-32, at 32 (filed Apr. 6, 1998). As GTE explained in its Comments, fiber is only one minor part of what is needed to deploy a long distance network. GTE Comments at 21-30.

[42] D. Diamond, "Building the Future-Proof Telco," *Wired*, June 1998. AT&T's executive vice president of network and computing services, Frank Ianna, had a similar reaction: "Anyone can deploy fiber, but that doesn't make a service that is functional and usable for mission-critical operations." *Id.*

service with end-to-end control and a variety of features" and cost advantages."[43] Although new entrants may have many miles of fiber, this alone does not translate into the ability to provide services. Numerous other inputs, in addition to fiber, are required to provide competitive long distance services:

- rights of way and conduits;
- electronic and photonic equipment to light the fiber;
- mulitplexers and cross-connects to parse the raw capacity into usable pieces for various services and customers;
- switches to route calls to the proper locations;
- signaling systems to set up the calls along the network;
- network control centers to monitor and manage the network;
- developing or leasing of POPs;
- purchasing or leasing transport from the backbone to at least one POP in each of the LATAs;
- customized software so that the network functions as a whole;
- order taking systems;
- billing systems;
- access agreements and facilities to connect POPs to the LEC network; and
- operator services.[44]

It is both time-consuming and expensive for new entrants to develop all of the facilities and resources necessary to provide competitive service at the level of WorldCom today.

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[43] Schmalensee/Taylor Reply Affidavit at 7.

[44] Schmalensee/Taylor Reply Affidavit at 11-12.

As explained below, the new entrants cited by the Applicants are many years away from accomplishing this goal.

Qwest. Drs. Carlton and Sider claim that Qwest will have population coverage of 78.4 percent by 1999.[45] However, Qwest's network is still very small, with revenues of only $115 million. Further, Qwest's network is being built with only two fibers lit, giving it no redundancy, protection from outages, or diversity, and making it a weak competitor to the largest three carriers. Drs. Carlton and Sider also ignore the fact that Qwest is delayed in the deployment of its network. In fact, Qwest apparently has not completed 41 percent of the network that was supposed to be ready for Frontier as of April 30, 1998.[46]

Williams. The Carlton/Sider Declaration calculates that the Williams Company will have 69.3 percent coverage.[47] In reality, Williams is running two separate networks, Vyvx and Wilcom. Vyvx's non-compete agreement with WorldCom limits Vyvx to multimedia and private line services (specifically prohibiting voice and data

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[45] Second Joint Reply, Carlton/Sider Declaration at 11.

[46] Harris LD Reply Affidavit at 26-27. As can be seen from Qwest's experience with the buildout of its planned network, the main barrier to entry into the provision of wholesale long-distance network services is the inherent difficulty of constructing and engineering a new national network. Qwest appears to be well capitalized, and has attracted over 100,000 customers since it entered into its marketing alliance with US West. Yet Qwest has had to rely on resale of other network providers' wholesale service to service the customers it has attracted, as it is has been unable to build out its network as quickly as it had hoped. *Id.* at 34.

[47] Second Joint Reply, Carlton/Sider Declaration at 11.

transmission) and only one fiber.[48] Wilcom is being built currently and many of the POPs listed by Drs. Carlton and Sider are off-net, making them more expensive and dependent upon rates charged by other carriers. Thus, Williams's actual coverage is much lower than the Applicants' numbers show.[49]

IXC. Drs. Carlton and Sider assert that IXC covers 61.4 percent of the population.[50] However, only a small fraction of IXC's network is currently operational. For example, the New York to Los Angeles route was only put into service on April 10 of this year. In addition, many of the POPs that IXC includes in its network coverage calculations are off-net. Therefore, IXC does not have sufficient facilities to challenge WorldCom.[51]

Level 3 Communications. Similarly, Level 3 will not be able to compete with the Big 3 long distance carriers or WorldCom. Level 3 just announced its construction plans in January of this year and only recently secured the final railroad rights-of-way for its fiber network. GTE believes it will be at least five years before Level 3 is able to deploy an extensive fiber optic system.[52]

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[48] Williams has filed suit against WorldCom over a number of issues surrounding the Vyvx network.

[49] Harris LD Reply Affidavit at 24-25.

[50] Second Joint Reply, Carlton/Sider Declaration at 11.

[51] Harris LD Reply Affidavit at 26.

[52] Harris LD Reply Affidavit at 29-30.

In sum, to represent accurately the competitive outlook, the following factors must be included in any coverage analysis: (1) in many LATAs, the BOC is not the only local exchange provider, so more than one POP may be necessary to connect with customers' LECs; (2) off-net POPs should not be counted since they are leased facilities and thus cost significantly more than owned facilities; (3) Williams' Vyvx network is bound by a non-compete restriction; (4) some carriers, including Qwest, are experiencing delays in the construction of their networks; and (5) growth of the incumbent carriers will prevent new entrants from "catching up." If these factors were considered in the coverage analysis in the Carlton/Sider Declaration, the results would show that the new entrants do not have coverage anywhere near the level that an independent WorldCom would have.[53]

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[53] Notably, none of the RBOCs or major independent LECs has agreed to resell the interexchange voice services of any of the new entrants mentioned by Drs. Carlton and Sider. This demonstrates the non-competitive nature of these new networks in the switched voice wholesale market. As Dr. Harris explains:

> Although US West and Ameritech have both entered into marketing pacts with Qwest, these are *not* resale arrangements between the BOCs and Qwest. Qwest is reselling service it acquires from other carriers (as it must, lacking a complete national network), and is paying a small fee to the two BOCs to serve as marketing agents for its Qwest-brand long-distance service. In conclusion, the reason none of the local companies are buying wholesale voice capacity from the hybrid carriers is that resellers require the ability to complete long-distance calls anywhere in the United States, and the only carriers who can reliably provide this service at competitive rates are WorldCom and the Big Three.

Harris LD Reply Affidavit at 31.

Even with its aggressive growth strategies and numerous acquisitions, WorldCom needed several years to assume its current position in the wholesale market. For example, it took WorldCom:

- 11 years to grow from Qwest/LCI's current wholesale revenues to WorldCom's current (1997) wholesale revenues;
- 7 years to grow from IXC's current wholesale revenues to WorldCom's 1997 revenues;
- 6 years to grow from Frontier's current wholesale revenues to WorldCom's 1997 wholesale revenues; and
- from 5-11 years to grow from the above new entrants' current total toll revenues to WorldCom's 1997 total toll revenues.[54]

The Applicants provide no evidence to show that current new entrants' growth rates will be any greater, nor is it possible to do so considering WorldCom's impressive growth.

2. New entrants with limited coverage will not exert competitive pressure on a national basis.

The Applicants assert that new entrants, despite their limited size and coverage, will be able to exercise a significant competitive effect on the larger IXCs. However, as shown below, there are numerous reasons this is not the case. Incumbents have significant scale and density advantages that new entrants lack and will be unable to achieve in time to prevent a wholesale price increase if the merger were approved. As GTE explained in its Comments, economies of scale are critical to competing with the

[54] Schmalensee/Taylor Reply Affidavit at 13. Drs. Schmalensee and Taylor provide a detailed description of new entrants' growth rates and how long it will take each new entrant to achieve revenues equal to that of WorldCom today. *Id.* at 18-20.

largest three IXCs.[55] The Affidavit of Sunit Patel states that MCI and WorldCom expect to achieve large cost savings that will make the combined companies more competitive.[56] This claim is inconsistent with the Applicants' assertion that no barriers to entry exist: if these savings are so large, then of necessity, any smaller competitor will be unable to operate as efficiently as MCI WorldCom.[57] Given how much smaller the new entrants cited by the Applicants are compared with WorldCom today, it is "highly unlikely that [they] will match the long-distance traffic volumes that WorldCom has now for at least the next several years, and it is all but impossible that their volumes will approach WorldCom's likely traffic volumes two to three years from now."[58]

As Drs. Schmalensee and Taylor note in their Reply Affidavit:

> WorldCom has already developed an extensive wholesale service package that cannot easily be reproduced by the entrants. Further, retail competitors who try to utilize the entrants' more limited wholesale services and less extensive networks are likely to find a higher cost alternative than that which WorldCom could make available, absent the merger.[59]

For example, new entrants are likely to have higher costs than incumbents in the following areas:

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[55] GTE Comments, Appendix 3, Harris Long Distance Affidavit at 20-21.

[56] GTE disagrees with the extent and nature of the long distance efficiencies that the Applicants claim will flow from merger. See Section V; *see also* Schmalensee/Taylor Reply Affidavit at 22 n.40.

[57] Harris LD Reply Affidavit at 51-52.

[58] Schmalensee/Taylor Reply Affidavit at 15.

[59] *Id.* at 6.

- *Offnet transport costs.* Since new entrants will have smaller networks and lower traffic volumes, they will use a greater proportion of leased capacity in their long-haul network and to connect POPs to their backbone fiber route, which will increase their costs vis-à vis the larger carriers.

- *Costs for leased POPs.* New entrants must lease more POPs from the larger IXCs, which will raise their costs.

- *Switched access costs.* New entrants will have higher switched access costs because they have fewer Direct End Office Trunk connections from their POPs to LEC end offices and fewer facilities to connect from end offices to their POPs. These entrants also have lower-capacity access transport and fewer POPs in a given LATA, increasing the length and cost of facilities to connect to LEC switches.

- *Dedicated access costs.* WorldCom has local facilities of its own which it uses to reduce its access costs, and MCI expects to use these facilities to reduce the access costs of the combined company. New entrants will not have this advantage.

- *Signaling system costs.* New entrants will likely have to lease SS7 facilities, which will put them at a cost disadvantage compared with carriers such as WorldCom that have their own SS7 networks.

- *Costs for WATS services.* WorldCom and MCI expect to reduce their WATS costs as a result of the merger. Considerably smaller new entrants will not have this advantage.

- *Directory assistance.* Smaller carriers have smaller volumes of calls and will not be able to negotiate as competitive rates with LECs for directory assistance.

- *Debit card payments.* New entrants will have higher debit card costs than WorldCom because they will have fewer facilities and less bargaining power.[60]

Therefore, despite the conclusions of Drs. Carlton and Sider, only large scale entry will be able to put competitive pressure on incumbents. "[T]he entrants' efforts are unlikely to produce wholesale long distance telephone services equivalent in cost, quality and

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[60] *Id.* at 22-23.

features to WorldCom's in time to prevent WorldCom from raising its prices by a significant amount."[61]

The Applicants' other arguments regarding entry are similarly unavailing. For example, the new fiber networks cannot readily add capacity to serve routes where the largest three carriers exercise market power.[62] As explained in Dr. Harris's Reply Affidavit, a carrier must obtain a large volume of traffic before it becomes worthwhile to construct facilities. Until this traffic level is obtained, a carrier will lease capacity and obtain indefeasible rights of use rather than invest the considerable resources necessary to add capacity to a relatively thin route.[63] This reliance on the facilities-based carriers undermines new entrants' ability to compete aggressively in many geographic markets. As a result, once WorldCom's incentives change, the price pressure that could have been exerted by resellers on mass market retail rates absent the merger will be undermined.

Nor can GTE or other resellers practically combine the facilities of several new entrants in order to provide national service.[64] As explained in detail in Dr. Harris's Reply Affidavit, there are numerous problems with reselling the facilities of multiple carriers. For example, although different products, such as 1+ voice and 800 service,

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[61] *Id.* at 7.

[62] Second Joint Reply, Carlton/Sider Declaration at 14.

[63] Harris LD Reply Affidavit at 51.

[64] Second Joint Reply at 39-40.

could be provided by different carriers, such a strategy significantly increases transaction costs and business risks.

In addition, the Carrier Identification Code ("CIC") system, which indicates to the local exchange carrier how traffic from a customer should be routed, is not equipped in many cases to handle codes for more than one carrier in a state. Thus, GTE could not route its New York City customers' long distance traffic to one underlying carrier but its Albany customers' long distance traffic to another. The recent change from four to five digit CIC codes further complicates this process.[65]

Similarly, a reseller using multiple suppliers would have to ensure that its billing system can accommodate data tapes from different carriers utilizing different formats. Moreover, quality of service inevitably suffers when a multitude of suppliers are involved. Redundancy, which is so critical to preventing outages, is much more difficult with smaller carriers using leased facilities.[66] Thus, a combination of several small new entrants cannot be used as a substitute for WorldCom or the Big 3 carriers. Only a truly nationwide carrier, like WorldCom, can be an effective supplier of wholesale capacity.

3. RBOCs will initially enter the market as resellers and will provide no competition in the wholesale market.

The RBOCs have no greater ability than other new entrants to offset the loss of WorldCom as a maverick competitor in the wholesale market for at least the next five years. None of the RBOCs has a nationwide network or will be able to deploy such a

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[65] Harris LD Reply Affidavit at 32-33.

[66] *Id.* at 34.

network for several years. Although the RBOCs have some facilities used for local services that could be useful for providing in-region interLATA services, the Commission has determined that RBOCs are prohibited from using these facilities even after in-region entry.[67] Joint use of such facilities will not be possible until after the Section 272 restrictions expire. Thus, all of the RBOCs will operate primarily as resellers in the foreseeable future, both in-region and out-of-region, and therefore will be just as subject to manipulation by carriers providing wholesale services.

4. The growth of "other" carriers confirms the lack of competition for mass market consumers from the Big Three IXCs, rather than demonstrating that there are no significant barriers to entry in the wholesale market.

MCI and WorldCom claim that the growth of the "other" category from 12 to 16 percent of the retail market confirms that there are no barriers to entry.[68] In reality, however, the growth of this category shows that AT&T, MCI, and Sprint are content to earn high profits on their mass market customers without competing for market share, leaving the door open for new entrants to bring much-needed price competition to this market segment.[69] Entry into the long distance market is driven by the fact that new entrants recognize that prices are above cost.

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[67] *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, As Amended*, 12 FCC Rcd 8653, 8665-83 (1997) *aff'd*, *Bell Atlantic Tel. Companies, et al. v. FCC*, 131 F.3d 1044 (D.C. Cir. 1997).

[68] Second Joint Reply at 21-22.

[69] Harris LD Reply Affidavit at 16-17, 34-35.

Contrary to the Applicants' assertion,[70] the majority of the "other" category is still comprised of companies that are predominantly resellers[71] – and, as Dr. Harris showed in his initial Affidavit, the success of these carriers largely tracks WorldCom's growth as a maverick wholesaler.[72] The most recent data show that in 1997, the Big 3 IXCs' rates were substantially above those of resellers, with the difference being greatest for low use (1-40 minutes per month) customers.[73] If the merger were approved, it likely would raise resellers' input costs, and thus the "other" carriers would cease to be even an imperfect competitive check on the coordinated pricing exhibited by the largest three carriers in the mass market. The Applicants provide no evidence to show that any of the carriers in the "other" category are a significant presence in the wholesale market, and no such evidence exists.

For the few new entrants in the "other" category that are facilities-based carriers, MCI and WorldCom claim that "GTE overlooks the cost advantages that newer technologies give to recently-constructed fiber networks."[74] This assertion is unconvincing because these entrants do not possess any real advantages over existing carriers. As explained by Dr. Harris, incumbents can quickly deploy the same technology as new entrants. They also enjoy significant economies of scale and can

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[70] Second Joint Reply at 30, 32.

[71] Harris LD Reply Affidavit at 35.

[72] GTE Comments, Appendix 3, Harris LD Affidavit at 3,15.

[73] Schmalensee/Taylor Reply Affidavit at 45-50.

[74] Second Joint Reply at 38.

readily increase capacity at a cost far lower than laying new fiber from scratch. In contrast, new entrants have extremely high start-up costs, including costs of securing rights-of-way, constructing infrastructure, and laying fiber cables. Their operational costs are also higher than incumbents' because they are not large enough to achieve the same economies of scale, scope, and density.[75]

In sum, there is no basis for accepting MCI's and WorldCom's claims that there are no barriers to entry. Rather, those barriers are real and will prevent the RBOCs and any of the new fiber networks from being an effective competitive alternative in the wholesale market for at least five years.

D. By Undermining Competition from Resellers, the Merger Would Further Reinforce the Big 3 IXCs' Ability To Engage in Coordinated Pricing of Long Distance Service for Residential and Small Business Consumers.

MCI and WorldCom once again insist that the residential long distance market is "fiercely competitive,"[76] based largely on references to the high churn rate and MCI's five-cent Sunday offering. The Applicants also state that WorldCom is not a maverick now and, in any event, will not change its incentives to provide wholesale capacity after the merger.[77] Neither argument is correct. As Drs. Schmalensee and Taylor note:

> [N]otwithstanding the theoretical arguments that Drs. Carlton and Sider present regarding incentives, the other three major IXCs (especially MCI) have clearly shown that their

[75] Harris LD Reply Affidavit at 18-19.

[76] Second Joint Reply at 44.

[77] Carlton/Sider Declaration at 17.

incentives differ from WorldCom's. (If not, it is difficult to believe that the incumbents would have allowed WorldCom to capture so much of the wholesale market.) Thus, WorldCom's incentives to aggressively pursue the wholesale market would likely be diminished as a result of the merger. And, with the diminution of WorldCom's wholesale activities, Sprint and AT&T would have even less of an incentive to aggressively pursue wholesale business.[78]

1. The Big Three IXCs do not price-compete to serve residential and small business customers.

The Affidavits of Dr. Harris and Drs. Schmalensee and Taylor attached to GTE's Comments introduced compelling evidence that residential and small business customers do not enjoy competitive rates,[79] and the Applicants have utterly failed to refute that showing. MCI and WorldCom did not even attempt to rebut GTE's demonstration that access charges have not been fully passed through, but rather simply cite to the Big 3 IXCs' recent letters to Chairman Kennard.[80] These responses were vague and devoid of substantive evidence. In reality, the big IXCs still have not passed through the full extent of access charge reductions to consumers, undermining any claim that the residential and small business market is competitive.

The high churn rate in retail long distance services can best be explained by the pervasive advertising and confusing rate plans offered by the largest three carriers, which create the appearance of competition without actually resulting in lower rates.

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[78] Schmalensee/Taylor Reply Affidavit at 40.

[79] GTE Comments, Appendix 3, Harris LD Affidavit at 28-34, Appendix 4, Schmalensee/Taylor Affidavit at 6-11.

[80] Second Joint Reply at 20-21.

Accordingly, the merger must be analyzed against the background of a highly concentrated industry where the dominant players clearly possess joint market power and engage in cooperative, rather than competitive, pricing of mass market services.

2. The Applicants simply ignore record evidence that WorldCom acts as a maverick today.

Dr. Harris's Affidavit attached to GTE's Comments demonstrated in detail that WorldCom is a more responsive and reasonable supplier of wholesale capacity than AT&T, MCI, or Sprint. WorldCom has consistently offered better prices, terms, and conditions than the Big 3 carriers:

- WorldCom's prices are frequently lower than the Big 3 carriers, and this cost advantage is even greater when access charges are considered.[81]
- WorldCom passes through access charges to resellers at cost plus a modest administrative fee, while the Big 3 carriers mark up these charges.[82]
- WorldCom has generally been found to offer superior provisioning and billing services, including offering to bill access in sub-minute increments, rather than on a per minute basis.[83]
- WorldCom also offers free PIC-processing and has committed to offer dual-PIC processing, while the Big 3 charge for each PIC change and have not offered to implement dual-PIC processing.[84]
- WorldCom has proven more willing to develop specific platforms to offer enhanced services, allows resellers to inform potential customers that WorldCom

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[81] GTE Comments, Appendix 3, Harris LD Affidavit at 37-39.

[82] *Id.*

[83] *Id.* at 35.

[84] *Id.* at 38.

is the underlying provider of the network service, and re-brands its services for resellers.[85]

MCI and WorldCom wholly ignore this evidence. Instead, they contend, without support, that all major IXCs are willing and responsive providers of wholesale capacity.[86] In light of the evidence showing that it is only in the face of WorldCom's aggressive marketing that the other major IXCs are willing even to consider providing competitive rates and conditions for resale, the Applicants' unsupported assertions should be given no weight.

WorldCom's maverick status is further confirmed by the contracts it has negotiated with the RBOCs and large ILECs. Without WorldCom's aggressive participation in the wholesale market, the RBOCs and large ILECs such as GTE would have received much less competitive terms and conditions. Ameritech was the first RBOC to negotiate a resale contract, and like GTE, it chose WorldCom. It was not until this contract was signed that AT&T and Sprint were willing to negotiate reasonable terms with other ILECs. After the Ameritech deal, Southwestern Bell Mobile, the largest RBOC out-of-region market participant, signed a contract with WorldCom. All other RBOCs have agreed to purchase services from AT&T or Sprint.[87]

Notably, no RBOC has signed a resale deal with MCI. Although the Applicants state that "MCI WorldCom cannot discriminate against a reseller depending on who the

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[85] *Id.* at 37-39.

[86] Second Joint Reply at 43.

[87] Harris LD Reply Affidavit at 31.

reseller's customer may be,"[88] MCI attempted to include exactly these types of terms in its negotiations with Bell Atlantic.[89] It is this type of behavior that GTE fears will permeate a merged MCI WorldCom, leaving resellers with no aggressive wholesale supplier.

The Applicants also assert that, if GTE is correct in characterizing WorldCom as the only willing participant in the wholesale market, the merger will not increase WorldCom's ability to earn monopoly profits because it would already be doing so.[90] As Dr. Harris explains in his Reply Affidavit, this analysis mischaracterizes the current competitive dynamic.[91] With the smallest retail market share and least known brand name of the large facilities-based carriers, WorldCom has a strong incentive to participate aggressively in the wholesale market. WorldCom's competitive offerings force the next smallest carrier, Sprint, to offer more competitive wholesale offerings.[92] As discussed below, however, if WorldCom acquires MCI's large retail base and brand name, its incentives to participate in the wholesale market would change drastically.

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[88] Second Joint Reply at 42.

[89] Bell Atlantic Further Comments, CC Docket No. 97-211, at 3 (filed Mar. 13, 1998).

[90] Second Joint Reply, Carlton/Sider Declaration at 35.

[91] Harris LD Reply Affidavit at 36-37.

[92] Even if WorldCom were charging a monopoly, profit-maximizing price, the merger would still cause this price to rise. WorldCom's opportunity costs for selling wholesale services would increase after its merger with MCI; thus, its profit-maximizing price would rise as well. Schmalensee/Taylor Reply Affidavit at 38.

3. After the merger, WorldCom would resist resale as much as MCI does today, in order to protect its newly acquired retail customer base.

The Applicants suggest several reasons why the combined company would still have the same incentives as WorldCom does today to participate aggressively in the wholesale market. None of these arguments has merit.[93]

The combined MCI WorldCom will have a significantly different customer and revenue make-up than WorldCom's current operations. WorldCom derives approximately 28 percent of its long-distance revenues from wholesale sales overall, while MCI derives only from 2.4 to 7 percent of its long distance revenues in that way, depending on the data source.[94] After the merger, WorldCom would go from having a negligible retail presence for residential and small business customers to being the second largest carrier in this retail market segment. Therefore, the combined company will be much more retail-focused and correspondingly motivated to protect its mass market base. An example of such behavior is MCI's effort to force Bell Atlantic to agree not to compete with MCI customers using MCI's resale services.[95]

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[93] As GTE explained in its Comments, the effect of the merger announcement on the stock market shows that it is expected to have an anti-competitive effect. GTE Comments at 42-44. Contrary to the assertions of Drs. Carlton and Sider, Dr. Harris's LD Reply Affidavit explains that there is significant support for using longer-term time windows for studying events such as mergers. Harris LD Reply Affidavit at 45-46.

[94] GTE Comments, Appendix 4, Schmalensee/Taylor Affidavit, Exhibits 9 and 10.

[95] Bell Atlantic Further Comments, CC Docket No. 97-211 at 3 (filed Mar. 13, 1998).

MCI and WorldCom argue that, because they will have only 18 percent of presubscribed lines after the merger, it would be irrational for the combined MCI WorldCom to restrict its marketing activities.[96] They also contend that resellers disproportionately take customers away from AT&T, and thus "a customer . . . might be lost anyway to a reseller who obtains capacity from a competitor if MCI WorldCom will not provide it."[97] This argument is not supported by the facts. As demonstrated by Dr. Harris' diversion analysis, under current conditions, any increase in wholesale supply in either the residential/small business market or the large business market provides a net *gain* to WorldCom. However, a similar increase in wholesale sales for MCI would result in a net *loss* in both markets. When the carriers are considered together, an increase in wholesale supply would result in larger losses for a combined MCI WorldCom than for MCI alone.[98] This analysis clearly demonstrates how the incentives of MCI WorldCom would differ from those of WorldCom today.[99]

Regardless of whether Drs. Carlton and Sider are correct that AT&T loses more customers to resellers than other carriers do,[100] the diversion analysis shows that a

[96] Second Joint Reply at 41.

[97] *Id.* at 42.

[98] Harris LD Reply Affidavit at 37-40.

[99] The language in WorldCom's Securities and Exchange Commission filings show that its incentives and behavior already have begun to change. Its most recent 10-K emphasizes providing "end-to-end bundled service" and does not mention the wholesale market, while previous filings have discussed its wholesale business explicitly. *See* Schmalensee/Taylor Reply Affidavit at 38-39.

[100] Second Joint Reply, Carlton/Sider Declaration at 5.

combined MCI WorldCom would still suffer a loss by increasing wholesale supply. Further, estimates of AT&T's low-volume residential market share frequently overstate AT&T's actual competitive position. AT&T serves a high proportion of the one-third of households that make less than $10 per month in long distance calls. These customers have stayed with AT&T since its break-up and have little incentive to change carriers. If MCI's market share were adjusted upward to take this factor into account, the diversion analysis would show an even larger loss for MCI for any increase in wholesale supply.[101]

MCI and WorldCom further attempt to dispute GTE's showing that WorldCom's incentive to be an aggressive reseller will be undermined after the merger by citing to the experience of Qwest/LCI and LDDS/WilTel.[102] The flaw with this argument is that none of the carriers referenced by the Applicants has a substantial retail market presence.[103] The Qwest/LCI merger proposes to combine two companies with exceedingly small retail shares. A diversion analysis for these carriers shows that in both the residential/small business and large business markets, the combined Qwest/LCI would have almost identical gains from increasing wholesale supply as the companies would individually.[104] Thus, this situation is completely different from that faced by WorldCom and MCI. In the case of WilTel, WilTel was a larger company than

[101] Harris LD Reply Affidavit at 40.

[102] Second Joint Reply at 42-43.

[103] In any event, the Qwest/LCI merger has not yet been consummated.

[104] Harris LD Reply Affidavit at 41.

LDDS and that merger was a three-way combination with Resurgens, another wholesaler. The very danger of the WorldCom/MCI merger is that it would greatly increase WorldCom's retail market share, to the point where continued support of resellers would diminish the combined company's profits.[105]

* * *

Despite MCI's and WorldCom's protestations to the contrary, their merger would have a significant adverse effect on the wholesale provision of long distance services to resellers. Residential and small business customers do not currently benefit from competition by the Big 3 carriers. The main source of competition for these customers is resellers, most of whom obtain their capacity from WorldCom. After the merger, WorldCom would lose its incentive to participate in the wholesale supply market aggressively, leaving no real competitive forces for the mass market. Therefore, the Commission should find that the WorldCom/MCI merger would adversely affect long distance competition and consumers.

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[105] A better example of how an expanded retail customer base can affect a company's incentives is evident from the change in Telecom*USA since it was purchased by MCI. Before the acquisition, Telecom*USA was an aggressive competitor offering prices lower than the three major carriers, including MCI. Since the acquisition, Telecom*USA has consistently charged prices that are higher than MCI's. Harris LD Reply Affidavit at 42. In fact, what the Telecom*USA marketing shows is that MCI has an incentive to price discriminate. Rather than cannibalizing its own retail customers, MCI has targeted the Telecom*USA dial-around service to AT&T basic-rate customers. Schmalensee/Taylor Reply Affidavit at 36.